Q1 2019 Tapestry Inc Earnings Call - Final

FD (Fair Disclosure) Wire

October 30, 2018 Tuesday

Length: 9848 words

Body

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Presentation

OPERATOR: Good day, and welcome to this Tapestry conference call. Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the call over to Andrea Resnick, Global Head of Investor Relations and Corporate Communications.

ANDREA SHAW RESNICK, GLOBAL HEAD OF IR & CORPORATE COMMUNICATIONS, TAPESTRY, INC.: Good morning, and thank you for joining us. With me today to discuss our quarterly results are Victor Luis, Tapestry's Chief Executive Officer; and Kevin Willis, Tapestry's Chief Financial Officer.

Before we begin, we must point out that this conference call will involve certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act, including projections for our business in the current or future quarters or fiscal years. Forward-looking statements are not guarantees and our actual results may differ materially from those expressed or implied in the forward-looking statements. Please refer to our annual report on Form 10-K, the press release we issued this morning and our other filings with the Securities and Exchange Commission for a complete list of risks and important factors that could impact our future results and performance.

Non-GAAP financial measures are included in our comments today and our presentation slides. You may find the corresponding GAAP financial information as well as the related reconciliations on our website, *www.tapestry.com/investors*, and then viewing the earnings release posted today and the presentation slides.

Now let me outline the speakers and topics for this conference call. Victor Luis will provide an overall summary of our first fiscal quarter 2019 results for Tapestry as well as our 3 brands. Kevin Willis will continue with details on financial and operational results of the quarter and our outlook for FY '19. Following that, we will hold a question-and-answer session, where we will be joined by Todd Kahn, Tapestry's President and Chief Administrative Officer; and Josh Schulman, CEO and brand President of Coach. Both Eraldo Poletto and Anna Bakst are traveling and could not attend. Following Q&A, we will conclude with some brief summary remarks.

I'd now like to turn it over to Victor Luis, Tapestry's CEO.

VICTOR LUIS, CEO & DIRECTOR, TAPESTRY, INC.: Good morning. Thank you, Andrea, and welcome, everyone. At the 1 year anniversary of our establishing Tapestry as our new corporate identity, our results continued to reflect the benefits of our diversified, multi-brand model. Our solid first quarter performance was consistent with our expectations, as we achieved strong increases in sales and operating income while earnings per share gains were further enhanced by a favorable tax rate.

Our teams across Tapestry remain focused on executing our 4 strategic priorities. First, continuing to harness the power of our multi-brand model. Driven by gross margin expansion, synergy capture was evident in the significant operating leverage we achieved in Kate Spade's first quarter results. To that end, we remain on track to achieve run-rate synergies from both COGS and SG&A of approximately $100 million to $115 million in fiscal 2019, up from $45 million in fiscal year '18. We've also continued to make progress on building a scalable shared services model, including investments in systems and infrastructure to support our current and future growth initiatives.

Earlier this month, after over 2 years of designing, building and testing, we deployed the first phase of our ERP implementation, SAPs, [S4 Hannah], successfully migrating our global finance functions for Tapestry, Coach and

Stuart Weitzman with Kate Spade to follow during the third quarter. And as part of our Tapestry culture and core values focused on good corporate citizenship, we issued our annual corporate responsibility report, the first to include both Stuart Weitzman and Kate Spade, available on Tapestry.com. This report is centered on the progress we've made on our 3 strategic corporate responsibility pillars: environment and supply chain, community engagements and employee empowerment. We were also delighted to become a signatory to the UN Global compact earlier this month.

Second, fueling innovation. Across all of our brands, we were and are focused on delivering distinctive newness and compelling product across categories and channels. We understand that innovation is what drives velocity of purchase in our key categories, and having a nimble, flexible supply chain, which we leverage across brands, enables us to deliver a higher level of innovation with increased frequency. Nowhere was this focus more apparent than our runway shows for Coach and Kate Spade during New York Fashion Week as well as Stuart Weitzman's spring collection showing for the trade, all of which were very well received.

Third, driving global growth. During September and October, we completed the buybacks of the Kate Spade operations in Singapore, Malaysia and Australia as well as the Stuart Weitzman business in southern China. We were also excited to announce an agreement to acquire the Stuart Weitzman business in Australia from our distributor partner, which is expected to close next summer. These initiatives will allow us to accelerate international growth and enhance each brands' development in these markets.

As in the case of the initiatives previously announced, these agreements are focused on 2 global strategic priorities: first, leveraging the opportunities for our brands with the Chinese consumer globally; and secondly, unlocking the value of a multi-brand operating model. While we understand that there are some near-term concerns around Chinese luxury spending, we view China's heightened emphasis on driving domestic demand as entirely aligned with where we are making our investments across brands. This is evidenced by our recent distributor buybacks, new store openings and marketing spend. Indeed, we believe further investment in domestic markets, with China, the most important, is the best hedge against the volatility that may at times occur in tourist spending.

During the first quarter, we added 24 net new stores across brands, including the acquired businesses. These new locations were primarily focused in international markets and took our directly operated store total to 1,456.

And fourth, advancing our digital and data analytics capabilities. Across all brands, we are driving superior results for our online channels and remain committed to delivering a seamless online, offline experience. Our Data Labs team is focused on further strengthening and integrating our customer database platform and supporting customer relationship management programs in each of our brands; advancing data tools to drive aggregate business insights across the organization; innovating with advanced analytics to optimize key processes, for example, using machine learning on product allocation, pricing or promotion planning.

The team is making substantial progress on helping us become even more data-driven and predictive, building on the solid foundation we have created. Early accomplishments include focusing the team into 4 main groups: data engineers; data scientists; product teams; and business analytics, moving all of our data in-house into the cloud, hugely important for security, agility and capacity and integrating North America and Japan customer data for Kate Spade into our central database.

Finally, taking the learnings from Coach and implementing customer capture reporting and tracking capabilities for all of our stores across all of our brands.

Moving forward, we remain focused, first and foremost, on execution. As you know, our goal is to deliver strong revenue and operating income growth in fiscal 2019 while making the right strategic investments to support our long-term vision and return to double-digit operating income and EPS growth in FY '20. Overall, we are proud of our continued progress in the first quarter and remain very excited about the opportunities ahead for Tapestry and each of our brands.

Now returning to the first quarter results and starting with category trends. During the first quarter, we estimate that the men's and women's premium handbag and accessories market, which is now over $45 billion, grew at a high

single-digit rate globally on an organic basis, consistent with the June quarter. In U.S. dollars, the growth rate was also at the high single digits, a slight deceleration from the prior period given the appreciation of the dollar.

Looking at specific brand performance and starting with Coach. Global comparable store sales rose about 4% in Q1, led by outperformance in digital and reflected our compelling offering across categories and channels. Further, we drove leverage to the operating income line through significant gross margin expansion. There were many highlights of the quarter in keeping with our brands' priorities.

In retail, we successfully cascaded leather goods innovation from the runaway with the introduction of the dreamer family. This silhouette was initially shown in our February show and offers a range of sizes, embellishments and materials with most SKUs at $495 and above. It launched as the leading family in August and has maintained its position in terms of handbag penetration. In addition, our Charlie and Parker bag groups remain strong. We continued to reinforce Signature as a coveted brand icon by expanding the offering to a new feminine rose print and across multiple styles and categories, significantly expanding the platform's reach.

In September, we continued our partnership with Selena Gomez, launching our new cross-category collection. This included Selena's first ready-to-wear assortment with the brand along with 2 new handbags, the bond and the vintage-inspired Trail crossbody, and a selection of belt bags and small leather goods.

In outlet, we innovated to elevate with a substantial number of new style introductions. Included among the launches was The Edit in August, a collection of fashion forward bags with elevated materials, hardware and luxury detailing. The customer embraced the value proposition offered by these handbags, and we achieved a substantially higher AUR on this product. And consistent with our strategy to drive growth outside of our core women's bags and small leather goods categories, men's continued to comp across channels and geographies, driven by lifestyle, notably outerwear, ready-to-wear and footwear as well as specialty accessories. We were particularly excited to announce Michael B. Jordan as the first global face of Coach menswear business. His partnership with Coach will include global advertising campaigns for men's ready-to-wear, accessories and fragrance beginning with the spring 2019 season.

The partnership will also include special design projects with Stuart Vevers. Partnering with Michael, who is both cool and authentic, will allow us to reinforce and strengthen the focus that we've put on our men's business. We were very pleased with the performance of our women's and men's footwear assortment globally. In retail, our strong growth was led by our sport and casual offerings, notably on-trend sneakers. In outlet, we were excited by the traction we experienced in sneakers as well as women's loafers, slides and men's drivers. Our Signature platform also performed well in both our women's and men's offering and across channels.

We were also delighted with the growth we drove in e-commerce with notable strength in our full price retail dotcom business, both in North America and globally. The first phase of our site redesign is already in play with updated checkout functionality. We've also rolled out our digital clienteling platform, Client Compass, and our purchase feedback tool, Client Loop, to North American stores and dotcom.

On stores, our customization program, Coach Create, celebrated its 1 year anniversary this month. Customization is now offered in 110 stores, supported by over 200 on-site craftspeople. And by fiscal year-end, this service will be expanded to over 150 stores. An additional 200-plus locations currently offer the service through other facilities in North America and Asia. With the millennial focus on personalization and authenticity, it is not surprising that this program is helping to engage and recruit the younger consumer. Naturally, it also drives a higher UPT, given that the customer starts with a handbag purchase and then adds on embellishments. Overall, you will see continued expansion across women's and men's styles each month for customization as we move through fiscal year '19.

On marketing, we launched our fall campaign with new global faces and influencers, along with a cool update to our successful Selena Gomez marketing of last fall. And of course, our New York Fashion Week presentation again received praise from the editorial community. As mentioned, we were also excited to announce Michael B. Jordan as the first global ambassador for Coach men's.

More recently, we announced the new philanthropic partner for the Coach Foundation, The Future Project. This is an organization dedicated to providing dream directors in schools with high degrees of poverty in order to help students find the tools to unlock their own personal dreams. We are delighted to find a nonprofit that aligns so closely with Coach values and leverages our partnership with Michael B. Jordan to work with the brand on its first #dreamitreal campaign.

Now to get into a bit of comp detail on the quarter. Overall, our first quarter performance was fairly consistent with our previous trends, with global comparable store sales in bricks and mortar driven primarily by conversion, reflecting our strong product offering. In addition, we saw traffic rise in stores globally, which was not surprising, given the impact of natural disasters and holiday shifts in the prior year. Augmenting these in-store gains was the strength we saw in our e-commerce business globally.

During the quarter, our global Coach comp remained solid, rising 4%. North America and our international group comps were similar to the global level. Greater China comps, which now includes Taiwan, rose, and importantly, our business with the Chinese consumer increased globally. Japan was also positive while our other Asia businesses were quite strong. Europe comp was slightly negative, up against the strong comp in the year-ago quarter while European total sales rose, driven by new distribution.

Moving to wholesale. Our North America shipments again grew significantly during the quarter, driven in part by footwear while our promotional days in the channel continued to decline sharply from last year. We are especially pleased with our core handbag and accessories sales growth at retail across our department store partners.

Our international wholesale revenue was slightly below prior year in Q1, excluding Coach Australia and New Zealand, as the business has transitioned to a directly operated retail model. At POS, sales were essentially even with prior year on the same basis.

Overall, we are very pleased with Coach's performance in the quarter. And moving forward, we believe we are well positioned to generate global growth driven by delivering a heightened level of newness throughout the pyramid of fashion price and occasion across channels and geographies; continuing to build on our established and authentic Signature platform; driving growth beyond our core bags and accessories; utilizing technology and digital to enhance and modernize the customer experience, notably through customization; and amplifying our marketing message that balances unexpected brand impact and broad appeal.

Looking ahead to holiday, our goal across all channels is to continue to elevate and differentiate the brand by offering innovation and emotion to our product assortment, marketing and in-store experience with a special focus on gifting for the season.

Specifically in retail, this holiday season, we will transform our stores into the ultimate gifting destination, featuring our whimsical party animals and emotional gifts across all price points. We also address all her holiday party needs with festive platforms and polished -- and a polished evening capsule.

We will reinforce our Dreamer, Parker and Charlie handbag silhouettes in new sizes, materials and looks iterations. This will be the first holiday for each of these iconic silhouettes. Metallics for day to evening take center stage with the mini DREAMER 21; new updates to Parker, including the sophisticated carryall and sheep backpack to round out our best-selling Parker shoulder bag and crossbody. And of course, this will also be the first holiday in many years that Signature will be available in a meaningful way in our retail channel. We are building on the momentum by expanding the offer with new silhouettes and introducing metallic signature for a festive holiday take on Logo.

In men's as well, we have increased flow of newness including an on-trend assortment of lightweight leather and leather trim Signature-coated canvas backpacks and belt bags.

And in outlet, for the upcoming holiday season, we continue to innovate the assortment with the introduction of great new elevated silhouettes. In November, we offer new gifting bags across a range of sensibilities and price points. We are especially excited about the edit for holiday, including Cassidy, a perfect day to evening shoulder

bag with a sophisticated chain strap. In addition, our gifting assortment is stronger than ever with the infusion of glitter and an expansion of boxed gifts, including jewelry, small leather goods and cold-weather accessories.

As in retail, the men's assortment introduces more modern leather good silhouettes appropriate for active casual or the modern workplace together with a broader range of outerwear and lifestyle accessories.

This year, we will deliver a particularly strong Black Friday assortment. For the first time, we are offering the full range of lifestyle categories, including outerwear and shoes in addition to leather goods.

In addition, we launched an exciting new cross-category collaboration to surprise and delight our consumers in the peak of the holiday season. This emotional capture offers fun holiday novelty with glitter and limited edition collector's items in Signature.

In summary, we are excited about the holiday season and remain confident in our belief that the Coach brand will achieve another year of solid revenue growth.

Moving to Kate Spade. Kate Spade contributed significantly to our overall performance as we made continued progress on our integration efforts, including the realization of synergies and the execution of strategic initiatives. Most importantly, we were delighted by the very positive editorial and trade reception to Creative Director, Nicola Glass' inaugural collection presented in the brand's Spring 2019 New York Fashion Week runway show in September. This underscores our confidence in the return to positive comps in the second half of the fiscal year when the full collection launches globally.

Looking at results. First quarter sales totaled $325 million, up 21% from prior year. Top line results were driven by new stores and the consolidation of Kate Spade China. Sales also benefited from the inclusion of a full quarter of revenues as compared to the prior year, which excluded the 11-day stub period when Kate was not yet a part of Tapestry. This growth was partially offset by a planned pullback in wholesale disposition as well as the global decline in comparable store sales, which fell 5%.

Our online business was strong as we anniversaried last year's pullback in surprise flash sales. Comps were impacted by the lack of distinctive newness to drive the business as we prepared to transition to Nicola's new creative direction. In addition, as previously noted, there was a pull-forward of sales into the June quarter, which had reflected the strong and immediate heartfelt response from loyal customers to the tragic news of the founder's passing.

In retail, full-priced hand bags, small leather goods and tech posted gains. And within bags, backpacks were a standout, driving significant year-over-year increases. We also generated strong performance in totes and crossbodies, while the suede bags from our White Rock Road and Haight Street groups were well received. Personalization was also successful with our Make It Mine collection continuing to trend. Growth in small leather goods was primarily driven by crossbodies and wristlets.

Importantly, we were pleased by the customer response to the spring capsule, the buy now feature of Kate Spade's runaway show available for only 2 weeks in September. The Nicola medium shoulder bag, featuring the twist-lock hardware, a new brand code, was particularly well received. We also saw continued success with our ready-to-wear zoning test with comps trending above balance of chain, driven by conversion and expect to roll this out to nearly 40 more stores over the balance of the fiscal year.

On the outlet side, we saw success in nylon with strong performance in both bags and accessories, led by our poppy print. Backpacks continued to trend with our smaller shapes performing exceptionally well. Given the outlook consumers focus on durability, Saffiano remains important to our bag and wallet business. We also drove excellent results with our convertible shoulder bag as the customer appreciated the multifunctional aspects of this bag and its day-to-evening versatility.

Outside of handbags in outlet, we've seen jewelry and ready-to-wear perform well, notably dresses and outerwear as well as scarves.

Under the leadership of Anna Bakst and Nicola Glass, we continue to make progress on our 5 strategic pillars in the first quarter. First, on global expansion, we added 21 net new locations in Q1, including 6 acquired in Australia and are on track to add 60 to 70 stores globally, including distributor buybacks. To date, our new doors are meeting or exceeding our expectations at high levels of productivity.

Second, branding. We are evolving our brand messaging to play to our core attributes, fashionable and feminine, while addressing fun in a more universal way. And we've begun to create compelling and covetable brand icons and codes such as the Spade Turn Lock to make our product both instantly recognizable and more distinctive.

Third, we're introducing exceptional and aspirational product as seen last month at New York Fashion Week, upgrading products quality to elevated materials and construction while maintaining price, providing excellent value with our unique optimistic feminine positioning.

Fourth, we are creating immersive channel experiences and have started to roll -- and have started to roll out our new retail and outlet concepts. In fact, all of the openings thus far in fiscal year '19 have reflected the new color palette, enhanced visual merchandising elements and merchandising by category of our evolved store model.

And fifth, we are leveraging the Tapestry platform in capturing synergies for Kate Spade through COGS and indirect savings as we optimize our supply chain, notably for bags and small leather goods from raw materials buying and manufacturing through transportation and logistics. The Kate Spade team is also tapping into Tapestry's resources and expertise such as the global business development and store construction teams to accelerate growth and improved profitability.

As we look to the year ahead for Kate Spade, we remain confident that it will be a year of double-digit revenue growth, driven by new distribution, acquisitions and consolidations of distributed businesses and positive second half comps. And as previously noted, over our 3-year planning horizon, we continue to believe that Kate Spade can approach $2 billion in sales at significantly higher operating margins.

Finally, at Stuart Weitzman, trends improved from the prior quarter with sales only slightly below last year. The results, as anticipated, continued to be negatively impacted by development and delivery delays, which pressured sales and margins. Importantly, production levels and shipments have now stabilized, reflecting the investment in talent and processes we have made as well as the added manufacturing capacity. As a result, we remain on track to achieve profitable sales growth in the holiday quarter.

During first quarter, we were pleased about the consumer response to our new updated classic pumps and loafers as well as the SW-612 sneaker, which came in towards the end of the quarter and has seen excellent uptake. Given market trends, we had shifted investment into booties and saw success in North America and Asia. Our new backstretch booties, the 5050, are a nod to our iconic boot and performed strongly, which also bodes well for the reserved bootie just introduced last week. Importantly, during the quarter, we continued to make progress in addressing the issues, which arose last spring, as we continued our transition from a founder-led shoe manufacturer to a truly scalable global multi-category footwear and accessories brand. And as mentioned, the Stuart Weitzman team and business is expected to benefit greatly from the rollout of our Tapestry IS platform over the coming quarters.

Looking to fiscal year '19, our strategic priorities for Stuart Weitzman have not changed and our focus on creating a clear direction and improved execution the impact of which will have longer-term benefit beyond just the year ahead and to create a stable platform for sustainable growth. First and foremost, we are focused on further evolving and refining our product development processes and supply chain. We understand that this underpins our ability to achieve all of our goals, and therefore, is our most immediate priority. And as I just mentioned, we've already made significant progress and we'll continue to do so.

Second, we will expand our footwear offering and new classifications while maintaining our authority in boots and sandals. Third, we will expand globally with the focus on the Chinese consumer. As you know, we bought back our Northern China distributor in mid-February and closed on the acquisition of our Southern China business last month. We are delighted with the traction we are seeing with the Chinese consumer globally. We were also excited

to relaunch our brand in Japan, where we believe our unique blend of design and comfort will be embraced by the local consumer as well as the Chinese tourist. During the first quarter, we opened in the top 2 department store locations in the country, Isetan Shinjuku in Tokyo, and Hankyu Umeda in Osaka. Different from over distributor run SW businesses of the past, this time in Japan, we're operating the locations directly in close partnership with and gaining the synergies of the existing Tapestry infrastructure.

Fourth, growth beyond footwear. Gaining credibility and handbags and leather goods, which we showed to the trade for the first time during market week this August. And fifth, we are creating brand desire through powerful 360-degree marketing. We are building brand relevance with consumers through our identifiable seasonal advertising campaigns. To this point, we are very excited about our destination boots activation across all channels, which launched earlier this month. And we will be launching an influencer project in China this spring with a leading fashion influencer while continuing to benefit from our strong celebrity-following globally.

In summary, we've been successfully addressing the challenges in our supply chain and will be fully backed to quality and on-time deliveries this quarter. We remain excited about the opportunities for the brand across geographies, classifications and categories and are confident in our long-term vision under Eraldo's leadership and the very talented team he has built at Stuart Weitzman.

With that, I will turn it over to Kevin for the financial review of the quarter and our outlook. Kevin?

KEVIN G. WILLS, CFO, TAPESTRY, INC.: Thanks, Victor, and good morning. Victor has just taken you through the highlights and strategies. Let me now take you through some of the important financial details of the quarter as well as our outlook for fiscal year '19. Before I begin, please keep in mind, the comments I'm about to make are based on non-GAAP results. Corresponding GAAP results as well as the related reconciliation can be found in the earnings release posted on our website today.

In addition, as previously announced, beginning in FY '19, we changed our expense reporting to more closely align with the organizational structure and management of the business. Accordingly, our Q1 results are presented on this basis and our prior year results have been recast for comparability. For more information, please see our earnings release as well as the 8-K filed with the SEC today.

Now turning to the financial results for Tapestry. Overall, we delivered strong results in the first quarter, highlighted by revenue, operating income and EPS growth, reflecting the benefits of our multibrand model.

Total sales rose 7% on a reported and constant currency basis to approximately $1.4 billion. Touching on performance per brand, we delivered 4% growth at Coach, reflecting positive comparable store sales gain, with both North America and international, increasing over prior year. At Kate Spade, sales increased 21% on a reported basis or approximately 8% on a pro forma basis, assuming we owned Kate Spade for the entire quarter in the prior year.

Sales were primarily driven by new store distribution and the consolidation of the joint ventures from Mainland China, Hong Kong, Macau and Taiwan, partially offset by negative comparable store sales and a strategic pullback in wholesale disposition sales. At Stuart Weitzman, sales were down 1% versus last year, as expected, as development in delivery delays continued to pressure results.

Turning to gross margins. We generated significant gross margin expansion with total Tapestry gross margin of 67.8%, up 170 basis points versus prior year, driven by an increase in approximately 250 basis points of Coach due to product cost benefits and the anniversary of the inventory mix challenges in the prior year. Currency was a benefit of approximately 70 basis points to Coach's year-over-year gross margin increase in the quarter. In addition, Kate Spade's gross margin expanded 270 basis points versus the prior year, reflecting the realization of COG synergies as we migrate the brand onto the Tapestry supply chain. Stuart Weitzman's gross margin was down 790 basis points versus prior year, including 600 basis points of pressure from currency. SG&A expenses totaled $755 million and represented 54.6% of sales as compared to $683 million and 52.9%, respectively, in the prior year. The increase in SG&A expenses was driven, as projected, by costs associated with regional buybacks and joint venture consolidations as well as Kate Spade new store distribution. Our operating income totaled $181 million in the

quarter, representing an increase of 7% over prior year's operating income of $169 million. Operating margin was 13.1%, in line with prior year, driven by strong margin expansion at both Coach and Kate Spade, partially offset, as anticipated, by pressure in Stuart Weitzman.

As projected, net interest expense was $13 million for the quarter as compared to $21 million in the prior year. Our effective tax rate was 15.8% as compared to 19.3% in the prior year's Q1. The tax rate for the quarter was lower than projected, driven by the benefit from ASU 2016-09, equity compensation deduction, which cannot be forecasted. In addition, the net impact of the U.S. tax legislation changes compared favorably to our expectations with the GILTI Provision resulting in a lesser headwind than originally anticipated, while we also benefited from the foreign-derived intangible income, or FDII, deduction.

Taken together, our EPS was $0.48 in the quarter, up 16% over prior year. Now moving to global distribution of brands. For Coach, we closed a net of 5 locations globally. We opened 15 net new Kate Spade locations globally while acquiring 6 stores in Australia. And for Stuart Weitzman, we opened 2 net new locations and acquired 6 stores as part of the buyback of Southern China business.

Turning to our balance sheet and cash flows. At the end of the first quarter, our cash and short-term investments were approximately $1.1 billion while our borrowings outstanding were $1.6 billion, consisting primarily of senior notes. As previously discussed, reduction in our debt position as compared to prior year reflects the repayment of $1.1 billion in term loans in January of 2018.

Inventory levels at quarter end were $821 million as compared to ending inventory of $853 million in the year-ago period, a decrease of 4%. As a reminder, we did not normalize Kate Spade inventory levels until the back half of 2018. Importantly, we feel comfortable with our inventory position heading into the holiday season.

Net cash from operating activities was an outflow of $19 million as compared to an outflow of $104 million a year ago. Our CapEx spending was $55 million versus $49 million last year. Free cash flow was an outflow of $75 million versus an outflow of $153 million in the same period last year.

Now turning to our capital allocation policy. Our long-term priorities remain unchanged. First, we will continue to invest in our brands in order to drive sustainable growth and value creation; secondly, we will seek strategic acquisitions looking for great brands with opportunities for expansion; and finally, returning capital to shareholders with a focus on dividends. Overall, our strong balance sheet will support our growth initiatives while allowing us to maintain strategic flexibility.

Now moving to our 2019 outlook. Consistent with our prior practice, the following guidance is presented on a non-GAAP basis. Starting with sales, we continue to expect total revenues for Tapestry in fiscal 2019 to increase at a mid-single-digit rate from fiscal 2018 to $6.1 billion to $6.2 billion. This includes the expectation for low single-digit growth at Coach, driven by continued positive low single-digit comps. We expect Kate Spade sales to increase on a double-digit rate from reported fiscal 2018 results, fueled by new distribution as well as positive comps in the second half of the year. As discussed, we expect Stuart Weitzman revenue growth in the second fiscal quarter.

In addition, we continue to project the operating income growth rate to exceed revenue growth rate, driven by gross margin expansion, offset in part by SG&A deleverage. Our operating income growth reflects the organic gains of our business, the realization of incremental synergies from the Kate Spade acquisition as well as the impact of distributor consolidation and buybacks and systems investments. In addition, our guidance now contemplates the expected impact of announced China tariffs on handbags, which represents less than 5% of Tapestry's production.

Net interest expense is still expected to be approximately $50 million for the year. The full year fiscal 2019 tax rate is now projected at about 19% to 20%. The increase over prior year is due primarily to the introduction of a new tax regime requiring a current inclusion in U.S. federal taxable income of certain earnings of controlled foreign corporations known as GILTI. The decrease from the previous FY '19 tax rate guidance of 21% to 22%, reflects additional clarification around the impact of the GILTI Provision, the expected benefit from the foreign-derived intangible income, or FDII, deduction, and the actualized impact of the ASU 2016-09 equity compensation deduction in the first quarter. We continue to expect our weighted average diluted shares outstanding for the year to

be approximately 295 million. Overall, we are now projecting earnings per diluted share for the year in the range of $2.75 to $2.80, up from the previous guidance range of $2.70 to $2.80.

We still expect CapEx to be in the range of $300 million to $325 million in FY '19, which we would expect to be the peak level spend over our planning horizon. As outlined in the press release, we now expect to incur non-recurring, pretax charges of approximately $20 million attributable to the company's ERP implementation efforts and estimated pretax integration acquisition charges of approximately $60 million.

Finally, turning to our FY '19 directly operated distribution plans by brand. For Coach, we continue to expect a modest net decrease in our store count in FY '19, due primarily to net closures in North America and Japan. For Kate Spade, we remain on track to grow the brands' directly operated store base by 60 to 70 net new locations in FY '19. Specifically, we continue to project 40 to 50 net new door openings, notably in international markets where we see significant opportunity for growth. We've also added 21 locations to the acquisition of the brands operations in Singapore, Malaysia and Australia.

And for Stuart Weitzman, we expect to open approximately 30 net new locations this fiscal year, primarily in China. As announced, following the successful buyback of the brands business in Northern China in FY '18, we acquired the brands' operations in Southern China where there were a total of 6 locations. Beyond FY '19, we're also pleased to announce an agreement to buy back the Stuart Weitzman business in Australia, which we expect to close next summer.

In closing, we are pleased with our first quarter performance and the progress we've made on our strategic initiatives. We remain committed to the goal of delivering solid sales and operating income growth in fiscal 2019 while making the right strategic investments to support our long-term vision and return to double-digit operating income and EPS growth in FY '20. Overall, we continue to be optimistic about global opportunities across the Tapestry portfolio of brands, supported by a very healthy balance sheet and a strong team to drive results.

I'd now like to open it up to Q&A.

Questions and Answers

OPERATOR: (Operator Instructions) Our first question comes from the line of Bob Drbul of Guggenheim.

ROBERT SCOTT DRBUL, SENIOR MD, GUGGENHEIM SECURITIES, LLC, RESEARCH DIVISION: I was wondering if you could talk about China. What is your exposure to the Chinese consumer across the Tapestry portfolio? And how are you feeling about your focus on the Chinese consumer given what's transpiring?

VICTOR LUIS: Well, total Tapestry, Bob, we're more in the mid- to high teens today in terms of sales to Chinese consumers, which compares with some of the traditional luxury brands being as high as 30 or more, so really points to still tremendous opportunity for us, which is one of the reasons we're incredibly excited about the investments we're making in that market across all the brands. As we pointed in the past, all of the conditions there still point to tremendous opportunity for growth. You've got a very large market, very fast growing middle-class. Coach, which is the most mature brand in that market, has a 32% unaided awareness, which points to tremendous opportunities still as well for that brand and as well for Stuart Weitzman and Kate Spade, which are doing very well in the early stages there based on our experience, of course, over the last decade with Coach and have unaided awareness in the 2% to 3% range. And today, we've touched 70 cities with our brands, which compares with a 160 cities in that market that have a population of 1 million or more. So just really excited about the opportunity there. The consumer -- the category there with the Chinese consumer continues to outpace the growth that we're seeing globally overall. And some of the current fluctuations that we see are nothing new to what we've seen in the last decade, especially driven by, of course, exchange rate fluctuations.

ROBERT SCOTT DRBUL: Great. If I could just ask a follow-up. On the Kate Spade business, can you just talk about how you're feeling about the minus 5 comp? And do you have any concerns on the second half inflection that you've been looking for?

VICTOR LUIS: No. Look, if we take a look at both the fourth quarter and the first quarter and take a look at the 2-year stack in brick-and-mortar, you'll see that performance has been quite consistent. Obviously, there was a little bit of support from the Internet business, as we're no longer comping the flash pullback that we had last year. Incredibly pleased with the work that the team has done in driving all of our synergies, and of course, that's reflected in the 270 bps gross margin improvement that we saw and as you suggested, we've always talked about the inflection taking place in the second half once we get new product into stores, which we're very excited about. Not only are the internal teams excited about it because they already bought it and all of that is hitting in Q3. But we're also getting excitement from our wholesale customers, which we have seen in their enthusiasm. And as I mentioned in my notes, Bob, the capsule that we've launched for a couple of weeks got really nice positive reaction. So overall, very pleased. What we're seeing still today is just consistent performance over the last quarter, which has been impacted by the continued lack of newness until Nicola's collection comes in and potentially a small pull-forward in sales in the quarter, which is really reflected in the strong and immediate impact that we saw from loyal customers to the tragic news of our founder's passing. So all pointing towards the guidance that we've given.

OPERATOR: (Operator Instructions) Our next question comes from the line of David Schick of Consumer Edge Research.

DAVID ADAM SCHICK, DIRECTOR OF RESEARCH, SENIOR RETAIL ANALYST & MANAGING PARTNER, CONSUMER EDGE RESEARCH, LLC: Congrats on the traffic, talking about Coach brand. And if you could update us on -- so traffic was a driver of the comp, as you said. But update us on the different traction you're seeing in the price strata? It has been helpful in the past.

VICTOR LUIS: Sure. I'll let Josh discuss that.

JOSHUA G. SCHULMAN, CEO & BRAND PRESIDENT OF COACH, TAPESTRY, INC.: Yes. So in both channels, we have a strategy of good, better, best. And what you see in the retail channel is that AUR continued to be down, reflective of our deliberate strategy to build the $300 to $500 price bucket, which really started in the spring, in the second half of our fiscal '18. And some of the strengths of those introductions, notably, Parker and Charlie, continued into the first quarter. In addition, we were really pleased by the introduction of Dreamer, which Victor referenced in his opening remarks. And that starts -- really the key SKU starts at $495 and up from there. So we're feeling really good about our price mix in the retail channel. In the outlet channel, also as Victor mentioned, we were encouraged by the customer response to the Edit where we did see a higher maintained AUR in that particular product. Of course, the edit represented a relatively small penetration to the total, and so as a result, it didn't have a meaningful impact on the AUR and outlet in a significant way. That said, as you know, our gross margin in outlet, and specifically in North America outlet, it expanded significantly in the first quarter. And so we were really pleased with the learnings we've seen on the edit, and we are introducing an even broader array of newness with the holiday floorset that launches over the weekend. So we're excited about what we're seeing and we look forward to seeing the customers' reaction to this as we go into the peak of the holiday season.

OPERATOR: Our next question comes from the line of Ike Boruchow of Wells Fargo.

IRWIN BERNARD BORUCHOW, MD AND SENIOR SPECIALTY RETAIL ANALYST, WELLS FARGO SECURITIES, LLC, RESEARCH DIVISION: So Victor, so more so for the Coach brand. Maybe you could you just talk about it at a higher level, the promotional nature of the North America handbag business in the first quarter? Any directional changes, good or bad, full price or outlet? And then quickly for Kevin, as it relates to the really strong gross margin performance that you just saw in the first quarter, any chance you could piece out how much of that is cost tailwind versus pricing? And then how you're thinking about gross margin for the remainder of the year at Coach brand?

VICTOR LUIS: Well, I'll let Josh first discuss the promotional environment, and then we'll let Kevin jump in on gross margin. Josh?

JOSHUA G. SCHULMAN: Yes. The promotional environment really didn't change that much from what we've been seeing for most of the calendar year. Yes, and then as I mentioned, we were able, in that environment, to deliver a

significant expansion in our gross margin. So we expanded 250 basis points from the prior year. And specifically within there, our North America gross margin did expand significantly from last year as well as our entire North America direct businesses.

VICTOR LUIS: Kevin, and the same for the [drivers].

KEVIN G. WILLS: Sure. Overall we were very pleased with the gross margin performance for the quarter, as we indicated up about 170 basis points. We have not given specific guidance on the gross margin increase for the year. But reflective in our guidance, we are expecting aggregate gross margin expansion for the year. As Victor mentioned earlier, we feel good about the synergy work we're doing, which was reflective in part in the Kate gross margin performance for the quarter.

OPERATOR: Our next question comes from Erinn Murphy of Piper Jaffray.

ERINN ELISABETH MURPHY, MD AND SENIOR RESEARCH ANALYST, PIPER JAFFRAY COMPANIES, RESEARCH DIVISION: Just a couple for me. I wanted to go back to -- I know it's not a huge piece for you guys, but on tariffs, you said your guidance now assumes the tariff. Is it assuming they go up to 25%. And then I know a lot of your peers that have a much bigger exposure to China production are increasing price. Do you have any plans for price increases in spring of '19? Just trying to understand how you guys see the kind of playing field, particularly in your price segment, kind of working as we move into '19.

KEVIN G. WILLS: Sure. And this is Kevin. I will take the tariff question. As you indicated, the 5% or -- excuse me 10% tariff went into effect in the latter part of September, increasing to 25% on January 1. We have included that in our guidance and it is having a little bit of a headwind for us. But as we indicated in our comments, the good news is our production in China is less than 5% in handbags and small leather goods, so while little bit of headwind, it's certainly not a material impact at this point.

ERINN ELISABETH MURPHY: And -- so you're not taking pricing in spring of '19?

VICTOR LUIS: At this moment, we have no such plans. Of course, we'll continue to look at what happens should things shift. But at the moment we have no such plans.

ERINN ELISABETH MURPHY: Got it. And if I could just ask a clarification on David's outlet question. Can you just reference where AURs are now versus their former peak?

VICTOR LUIS: In terms of AUR by channel, we don't decide to take those and provide those, Erinn. But Josh, would you add anything?

JOSHUA G. SCHULMAN: Nothing more than what I explained about what we're seeing in the pricing trends in general.

OPERATOR: Our next question comes from Oliver Chen of Cowen and Company.

OLIVER CHEN, MD & SENIOR EQUITY RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: The Michael B. Jordan announcement is exciting. What are your thoughts in terms of how that will impact your customer profile and which product lines you see the most opportunity and any learnings from prior brand ambassadors that you'll take here? And then briefly on China, what are your thoughts on the Chinese customer who shops abroad and how that may manifest in your traffic profile. And also we've seen a little bit of caution on China consumer confidence. Just wondering how that interplays into what you're thinking. Great quarter.

VICTOR LUIS: Sure. Let me start with China and then I'll hand over to Josh on Michael B. Jordan and exciting work that the team is doing there. In terms of China, most of the impact that we see out is hardly much more than a lot of talk that we have heard about Daegu and other border controls is really based on the experience that we've had over the last decade or so around exchange rates, of course, and the impact that, that has around traffic flows globally. And of course, the appreciation of the dollar and depreciation of the RMB being the most impactful to travel. Overall, we feel really good about the domestic consumer. We're not seeing any negative impacts right now

and concerns around their confidence I would say. And what's exciting is that, I think over the last decade, we've seen that whenever there has been the potential for such shocks, Olly, the accessible luxury brands have fared well. We may not grow as quickly in the great times compared to traditional luxury. But when there are periods of crisis, we tend to be much more resilient as consumers continue to look for value, and I couldn't be more excited about the long-term opportunity for our brands in that market. On Michael B.?

JOSHUA G. SCHULMAN: So we couldn't be more excited about having Michael B. Jordan as our first global face for the Coach men's business. We've talked before, as you know about the importance of men's as driver for total Coach growth. It's currently about 20% of our business, and we see a clear path to $1 billion and beyond. And the collaboration with Michael B. Jordan really started in quite an organic way because he was already wearing Coach in a lot of his appearances. And we saw that he has a truly universal appeal and is really hitting his stride in his career in the types of projects and the types of press he's getting. I will tell you that Stuart than the entire team are so excited to be working with him. I don't know if you saw on social media, they were posting already this weekend shooting their first campaign together. They're already working on a product capsule. So this is really organic energy around him and the values that he represents and the universal appeal that he holds. So we're looking forward to great things from the collaboration.

OPERATOR: Our next question comes from the line of Mark Altschwager of Baird.

MARK R. ALTSCHWAGER, SENIOR RESEARCH ANALYST, ROBERT W. BAIRD & CO. INCORPORATED, RESEARCH DIVISION: I wanted to circle back on the Coach comps. Q1 results did benefit from the easier comparison last year. Could you just talk about how you're thinking about the pace of growth over the remainder of the year and any change that you're expecting in the relative contribution from North America versus international? And separately, I think, Victor, at the beginning, you talked about how tourist spending can be volatile. I'm wondering are you seeing signs of that volatility picking up at all within your North American stores.

JOSHUA G. SCHULMAN: In Q1, we were very pleased with the performance in both North America and International. As we look forward, we believe that we will be able to achieve the low single-digit comps in our guidance. And obviously, Q1 has the easier compare. As we go into the next 3 quarters, and particularly into the holiday period, we have no change in our expectations, either on the overall comp or on the geographic distribution of that.

VICTOR LUIS: And Mark, in terms of the tourist flow, it's pretty consistent over the last few quarters. What we're seeing is Asia performing better overall as the PRC consumer, the Chinese consumer continues to discover those markets from Japan down into Southeast Asia and Australia, much more so today than the U.S. or Europe. So pretty consistent trends.

OPERATOR: Our next question comes from the line of Alex Walvis of Goldman Sachs.

ALEXANDRA E. WALVIS, RESEARCH ANALYST, GOLDMAN SACHS GROUP INC., RESEARCH DIVISION: I had a question on Stuart Weitzman. You reiterated your guidance to achieve profitable sales growth in the second quarter. I was wondering if you could walk us through the changes that we should expect to see in that business from the first quarter to the second quarter that are likely to drive that inflection, and I'll be interested to understand the holiday strategy of the brand when new innovations are likely to be phased in. And then finally, whether there are any more delivery and development delays or are we past those at this stage?

VICTOR LUIS: Sure. Actually, very exciting in that this upcoming week, we begin very much on-time deliveries of our pre-spring products. So we are now fully back on track and on time and all of that product benefits from a lot of the work that the team has done in regards to fit and comfort and fashion. So very excited about that. Of course, the read that we have on that product right now it's both the orders from wholesale as well as, of course, our own internal teams buying it for our stores. So in many ways, I would say that we are returning to the core strengths of the brand. From a marketing perspective, you have seen that we have been very focused on one of the brand's strengths for the fall/winter season, which of course is boots and booties. And very excited with the launch as I mentioned in my notes, of our newest category, which is in the sneakers space, the SW-612 sneaker, which has

been very well-received and the team has been in chase mode right now to put back into inventory globally. So I would say that Eraldo and the team, of course, now focused on execution into the future seasons. But from basically the 1st week of November, we're back to very timely deliveries, quality and on track and have put the issues of the spring behind us.

OPERATOR: And we have time for one more question. Your question comes from Simeon Siegel of the Nomura Instinet.

SIMEON AVRAM SIEGEL, EXECUTIVE DIRECTOR & SENIOR ANALYST, NOMURA SECURITIES CO. LTD., RESEARCH DIVISION: Congrats on a strong Coach margins. Sorry if I missed it, did you say how North America versus International was? And then just with the moving pieces of the licenses. Are there any that are still licensed out geographically across demograph.

VICTOR LUIS: I think, Simeon, the second part of your question was on distribution buybacks?

SIMEON AVRAM SIEGEL: Yes. Yes, so just thinking -- yes.

VICTOR LUIS: Yes the vast majority across all the brands now are complete. So I would not expect anything further in the near term as we have very much now executed to our strategy of capturing the biggest opportunities, which as we mentioned, of course, being in Asia and with a focus on the Chinese consumer. And then in terms of U.S. and international, I'll let Josh touch on that.

JOSHUA G. SCHULMAN: Yes. We have said that both U.S. and International were similar to global.

SIMEON AVRAM SIEGEL: The comp or the margins?

JOSHUA G. SCHULMAN: In terms of comp.

SIMEON AVRAM SIEGEL: And I was just wondering...

JOSHUA G. SCHULMAN: And the margins as well. We saw global increases in margins. And I specifically mentioned North America direct and North America outlet. As you remember last year, we were particularly challenged in that channel with mix issues. But we did see it globally, the margin expansion.

ANDREA SHAW RESNICK: Thank you for joining us today. I will turn it back over to Victor for some concluding remarks. Victor?

VICTOR LUIS: Thank you, Andrea. I just want to say thank you to all of you for joining us as usual. And I want to close by congratulating all of our Tapestry and brand teams as we celebrate the first anniversary of our rebranding. They've worked incredibly hard. And I could not be prouder of our 20,000-strong team members across the globe. More importantly, we're laying an incredible foundation for a robust business model as the house of strong brands. And I could not be more excited by the endless opportunity ahead of us. Thank you.

OPERATOR: Thank you. Ladies and gentlemen, this does conclude today's call. You may now disconnect and have a wonderful day.

incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

Load-Date: November 8, 2018